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Determining Factors of Customers' Preferences: A Case of Deposit Products in Islamic Banking

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Abstract

Islamic banking and finance are areas that have attracted attention, especially after the recent global financial crisis. While the existing literature highlights a significant shift in consumers' behaviour with regard to bank selection, it does not investigate the motives behind such moves. Understanding customers' preferences to deposit their money into Islamic banks are crucial for banks operating in such a highly competitive industry. Having a good understanding of the real motives behind customers' preferences will help banks to understand customers better. Besides, improving the bank's liquidity issues, it contributes to the growth of the country's economy. Thus, this paper explores the findings from a qualitative data through a face to face interview on factors influencing customers' preferences for deposit products in Islamic banks. These results will eventually be used for developing a survey questionnaire for future empirical research. The face-to-face interview revealed that sharia compliance, returns, confidence and trust, security, transparency, flexibility of withdrawal scheme were among the determining factors that influence customers' preferences in making decisions. Safety and security, the human touch and zakat (alms) were the additional elements found to be missing from the literature. Future empirical research would include these elements as items in building up the survey instrument.

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1. Introduction

The finance and Banking sector plays a crucial role in the economy. As intermediaries between depositors and borrowers, it contributes to the economic growth by offering various products and services. Banks generate profits through interest from loans by charging higher rates than the cost of paying interest to depositors. Deposits remain a primary source of bank financing (Khir, Gupta, & Shanmugam, 2008). The interest is used by banks to determine the amount of returns in attracting depositors to pledge their money in the banks. Customers deposit their money in the banks due to returns and risks. Most people accept that there is a positive relationship between risk and return. In investment, customers always seek for high returns with minimal risks. However, this is not necessarily a reality. Investments that generate high returns typically have a higher risk.

The emergence of Islamic banking in a time of financial crisis in 2008 is evident worldwide. Previously, Islamic banking was known among the Muslim majority countries. After the financial crisis, many Islamic banks were institutionalized all over the world (Foster, 1983; Waemustafa, 2013). The world began to recognize Islamic banking as an alternative solution to the crisis that struck the financial industry (Ayub, 2007; Vandore, 2008). For instance, some leading commercial banks in the West started to offer products similar to Sharia-compliant products offer in Islamic banking (Haron & Ahmad, 2000). The impact of the financial turmoil has raised a question and left riddles unanswered. We witnessed the fragility of conventional banks and the consistency of Islamic banks in facing the financial crisis. During the period, traditional banks recorded a loss of US\$4.26 billion while Islamic banks were less affected and recorded a profit of US\$4.74 billion (Fam, Waller, & Erdogan, 2004). The world has seen the sudden shift of customers' behavior and perception towards Islamic banking. Customers begin to lose their faith in the current financial system (Al-Duri, 1986a). More interestingly, in Malaysia, the record shows an average annual deposit growth of 32% (USD\$40 billion in 2008 to USD\$100 billion in 2012). On the contrary, the share of conventional banking in total deposits has dropped from 92.5% in 2007 to 80.4% in 2012 (Ariff, 2014).

Despite the existence of relatively high risk in *mudarabah* (profit sharing) and no guaranteed returns under *wadiah* (guaranteed custody) contract, yet, customers continue to deposit their money in Islamic banking. These go in contradiction to the patrons motive of pledging their money in the first place, and are oppose to the fundamental principle of maximizing profit and avoiding the high risk. Perception of risks and returns being a primary force that drives customers' preferences no longer has binding, and its theories are incapable of explaining the unexpected change in customers' behavior. Customers' preferences have gone beyond risks and returns factor (Beal, Goyen, & Phillips, 2005; Fama & French, 2007; Fisher & Statman, 1997). What are the factors that influence customers' preferences to deposit their money in Islamic banking? What are the most critical factors perceived by customers that motivate them to pledge their money in Islamic banking? Understanding why customers prefer to deposit their money into Islamic banks is crucial for banks operating in such a highly competitive industry. Having a good understanding of the real motives behind customers' preferences will help banks in understanding customers better. As such, there is a need to formulate new client strategies to meet the rising expectations and demands. Specifically, improve in cash mobilization could help to solve liquidity issues in Islamic banks and at the same time contribute to the growth of the country's economy. Therefore, this paper is an attempt to explore factors that influence customers' preferences to deposit their money in Islamic banking. Besides, this paper also aims to identify the critical factors perceived as the most crucial driving forces that influence the customers' decision.

2. Literature review

2.1. Islamic banking concept

According to Malaysian Islamic Banking Act 1983, Islamic bank refers to "any company that carries on Islamic banking business and holds a valid license. All the offices and branches in Malaysia of such a bank shall be deemed to be one bank". The concept of Islamic banking has been narrated quite differently by many scholars. Rammal and Zurbruegg (2006), Bello (2007) and W. Ahmad (2008) explain Islamic banking as the banking system that follow the Islamic jurisprudence (Sharia law) and *muamalat* (business transaction). While Dar and Presley (2000) postulates that the dissimilarity lies in the profit sharing and is in compliance with sharia. Research carried out by Honohan (2001) includes a strict sense of recklessness or uncertainty (*gharar*), exploitation of ignorance (*jahl*) and gambling

(*maysir*) in his study. He noted the role of Islamic banking in the development of the country's economic ethically, morally and lawfully. The prohibition of usury (*Riba*) which forms one of the features of Islamic banking has been stressed too much by scholars. The Islamic banking financial system encompasses the laws on how humanity deals with financial transactions that form their daily way of life. Apart from being perceived as adhered to sharia compliance, all financial transactions were dealt in an honest and fair manner. These include no element of extortion, speculation; oppression, fraud and any treatment that may cause loss to any party involve in the contract. Several verses of the Holy Scriptures mentioned the teaching of human ethics. In Islam, to behave virtuously in all matters of life is referred to in the holy book of Al Quran in Surah Al-Baqarah verse 177 and Surah Maryam verse 19. In Judaism, it is referred to in the book of Zabur Psalms verse 119:172 and the book of Torah Isaiah verse 61:11. In Christianity, it is referred to in the Bible, Mathew verse 6:33 and Romans verse 3:22.

2.2. Deposit products

Functionally, there is no obvious distinction between deposit accounts of conventional and Islamic banking system. The dissimilarities lies in the types of the contract applied, whether it is *wadiah* (*guaranteed custody*) or *mudarabah* (*profit-sharing*). *Wadiah* contract means safe keeping or safe custody. All jurists of all schools unanimously agree that it is a form of trust and not a guarantee. Thus, the trustee is not liable to pay any compensation as a result of the property loss unless due to negligence (Al-Baqarah, 2:283). Whereas, *mudarabah* is an arrangement between two parties that is the capital provider (depositor) and the entrepreneur (bank) on an agreed project based on profit sharing basis. In the event of loss, all losses shall be borne entirely by the capital provider. Unless, if losses are due to entrepreneur's negligence or violation of the terms and conditions specified, then the obligation will go to the entrepreneur (Al-Tabrani, 1995).

2.3. Customers' preferences and theoretical viewpoints

Customers' preference is a marketing term that means the likelihood to choose one thing over another. In economic, consumers' preferences are defined as individual tastes and being measured by the utility of various bundles of goods (Sowunmi, Omigie, & Daniel, 2014; Thiyagaraj, 2015). Psychologically, preference is viewed as an individual's attitude towards a set of objects that stimulates, his or her behavior in the decision-making process (Lichtenstein & Slovic, 2006). The customer is making a choice decision in many ways, from the simple decision to a complex decision. It is a process by which customers are collecting relevant information regarding products' attributes; evaluate the information according to their preferences before assigning a value to choose between alternatives (Hawkins & Mothersbaugh, 2010). In some cases, nominal decisions do not need extensive evaluation, for example, repeat purchase, a decision made in a hurry or product that possesses few attributes. The decision will be simple and require less time without comparisons between alternatives. The normative theory of decision making states that customers would evaluate the options before making a decision that maximize the value of choice (Abelson & Levi, 1985; Lau, 1995).

The normative theory of 'Value Maximization' has been criticized heavily due to its ignorance on human limitation (Moorthy, Ratchford, & Talukdar, 1997; Thaler, 1985). Bounded rationality theory by Simon (1975) assumes that customers have limited processing capability and will end the search once suitable solutions have been identified. Typically, in the consumer decision process, they tend to follow the traditional five-steps evaluation process. The process includes problem recognition, information search, alternative evaluation, choice and outcome evaluation (Erasmus, Boshoff, & Rousseau, 2001; Shiffman & Kanuk, 2007). According to Engel Model, customers process decision comprises of defining problems, generate alternatives, evaluate alternatives, decide on the options, implement the decision and finally monitor the solutions (Engel, Blackwell, & Miniard, 1995)., the theory of buyer behavior by Howard and Sheth (1969), the consumer decision model by Blackwell and Miniard (2001), the theory of reasoned action by Fishbein and Ajzen (1975) and the theory of planned behavior by Ajzen (1985) are amongst the four extensively cited models in customers behavior. However, Solomon and Bamossy (2006) argue on the relevancy of the underpinning assumptions of other cultures. These findings were in line with the study by Bagozzi (2000) that commented the inclusion of few cross-cultural studies. However, to some extent, all the four cited

models and theories fail to address the role of ethics, social responsibility and philanthropy given in the intense rise in customers behavior issues (Bray, 2008).

2.4. Determining factors

Numerous preceding studies focused on the consequences or the outcomes as the factors that cause the customers to select the Islamic banks. The elements that lead to a good reputation, good image, loyal clients and so forth were not being studied extensively. An empirical study of Islamic product mix reveals the significance of moral issues such as being faithful, fair and truthful found to be of great essential in Islamic banking (Johari, Jamil, & Firdaus, 2013). In the study of consumer behavior, the critical issues affecting the virtuous morals receive less attention (Bray, 2008).

2.4.1. Sharia compliance

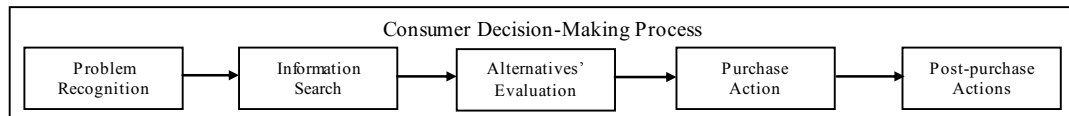
The objective of Sharia is to promote the welfare and the balance of life in civil society. According to Chapra (2000), the balance of life could only be gained by conformity to the provisions of *Maqasid al-Sharia*. In today's Islamic banking, the equity-based instrument has been given high priority rather than placing great emphasize on social welfare responsibility and religious commitment. The objectives to achieve equitable distribution of wealth and promoting economic development and growth could not be materialized if the concept is solely concentrated on generating profit (Ahmad & Ahmad, 2000). In a worldwide survey conducted by the Economist Intelligence Unit and commissioned by Kuwait Finance House in the year 2012 discloses that more than one-half (55%) of the respondents treated Sharia compliant finance as significant (Economist, 2012). Under the same survey, over one-half (52%) of survey respondents state the relative importance to embed honesty and integrity when offering the goods or services.

2.4.2. Religion/religious affiliation

Religious affiliation refers to “the particular religious group to which an individual belongs” (Lehrer, 2004). An extrinsically religious person tends to select and integrate religious teachings that suit their personal life's goals (Allport & Ross, 1967). In consumer marketing, the religious matter found to influence customers' decision making and preferences (Bonne, Vermeir, & Verbeke, 2007; Weaver & Agle, 2002). Religion is being inferred as one of the factors influencing customers' savings and investment behavior (Keister, 2003). Islamic bank in Turkey agreed that religion is the principle reason for Islamic bank product choice (Markotwiz, 1952). Another study conducted by Muslim investors in Malaysia establishes that religion has some influence on individual investment decision-making (Muhamad, Devi, & Abdul Mu'min, 2006). According to Metwally (1996), customers in Kuwait, Saudi Arabia and Egypt chose religion as the main reason that determines the attitudes of Muslims towards choosing an Islamic bank in their country. The study was being supported by Al-Sultan (1999) which proclaims the primary reason that motivate customers in Kuwait in dealing with Islamic bank products and service was because of the religious subject. Therefore, future empirical research should focus on the influence of religion or religious affiliation on the choice of Islamic deposit products.

3. Theoretical framework

The nature of evaluative criteria (product attributes) may include ranking those evaluative criteria according to its importance (Engel et al., 1995; Shiffman & Kanuk, 2007). The process on how customers evaluate and choose alternatives is shown in Figure 1.



Source: Adapted from Consumer Decision Model (also known as the Engel-Blackwell-Miniard Model) by Engel-Kollat-Blackwell (1968)

Fig. 1. Customers' preferences and customers' decision making process.

Figure 2 could explain the proposed model on how religion or religious affiliation could have an impact in influencing customers' preferences for deposit product.

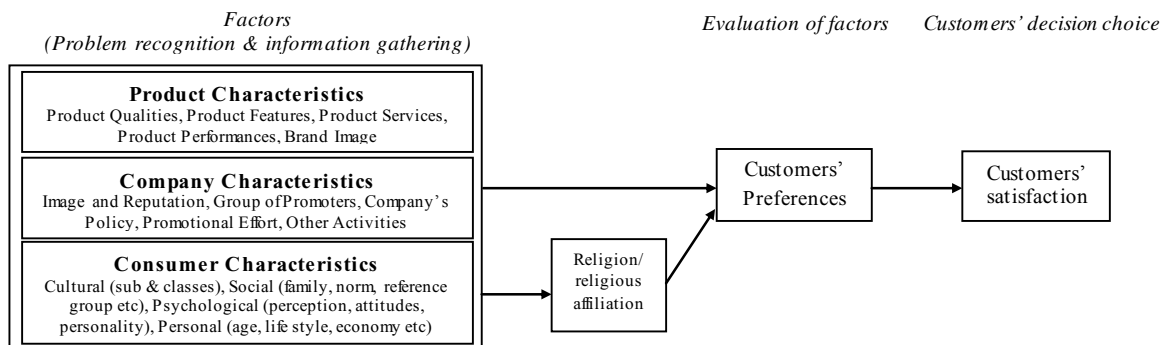


Fig. 2. Factors affecting customers' preferences for deposit products.

3. 1. Variables and mediating factor

The Theory of Buyer Behaviour by Howard and Sheth (1969) outlines seven exogenous variables and is being criticized for not defining individual buyers well (Loudon & Della Bitta, 1993). The model was criticized for lack of empirical work and scientific methods application. It was also criticized due to the lack of examination of the model in the organization and the inclusion of individuals constructs (Haines, 1970; Hunt & Pappas, 1972; Neman, 1972). For the purpose of this paper, the authors decided to use Consumer Model by Engel-Kollat-Blackwell. Due to its similarity in purpose, this model was adopted. Under this model, there are three exogenous variables, (Independent Variables) namely products characteristics, company characteristics and consumer characteristics, which influence the customers' choice. The endogenous (Dependent) variable in this study was customers' satisfaction. The religion or religious affiliation is expected to affect customers' preferences in evaluating the factors (independent variables) that subsequently lead to customers' satisfaction (dependent variables). Due to the exclusion of the role of ethics, social responsibility and philanthropy (Bray, 2008) in most theories of consumer behaviour, the authors decided to include these elements during the face-to-face interview with the participants.

4. Methodology

In research methodology, the most important factor that needs to be established is generalization (Polit & Hungler, 1991; Ryan & Bernard, 2000), whether the sample size adopted could infer the overall behavior of this population (customers) towards the deposit products in Islamic banks (Babbie, 1990). The sequential exploratory technique was frequently discussed and used when additional data is required for the purpose of building an instrument (Cresswell & Plano Clark, 2007). This paper explored the findings from a qualitative data through a face-to-face interview on factors influencing customers' preferences for the deposit products in Islamic banks. These results will eventually be used for developing a survey questionnaire for future empirical research.

4.1. Qualitative and quantitative phase

The first phase was a qualitative exploration of a behavior of the customers in adopting Islamic banking products under the contract of *wadiah* or *mudharabah* through a face-to-face interview from various categories and background of the participants. They were being contacted, and an appointment was confirmed on the date, day, time and place of the interview. Participants were asked to answer semi-structured questions during the interview session. For convenient and efficient communication, the place and time for the meeting were both agreed with the interviewer and the interviewees. Each interview was audiotaped and transcribed verbatim. It took two weeks to complete the whole interview. The purpose of conducting an interview with the participants was to enable views from the customers' perspective to be considered. This is important in ensuring the future empirical research represented by variables from both points of view. The target population covered the area of interest for conducting the proposed study (Churchill & Iacobucci, 2005). The sample size was determined when participants' responses are redundant or at the point of saturation (Glaser & Strauss, 1967; Klenke, 2008; Strauss & Corbin, 1998). The interview had attained the point of saturation when the third, the fourth, the fifth and the sixth respondents had discussed similar factors. Thus, the authors had decided to discontinue the interview with the sixth participants. Because of the fundamental change in customers' behavior, Muslim and non-Muslim customers were chosen as the target of the study. The data obtained from the qualitative phase would eventually be used for developing a survey questionnaire for the quantitative stage of the empirical research at the later stage. At this level, a large sample size will be used and collected by means of self-administered survey questionnaires, using non-probability sampling technique. For the purpose of analysis, Structural Equation Modeling, which includes exploratory factor analysis (EFA) and confirmatory factor analysis (CFA), would be adopted.

4.2. Data analysis procedures (qualitative phase)

Merriam (1998) and Marshall and Rosmann (2006) view that in qualitative research, data collection and analysis is a concurrent process. The data should be organized categorically and chronologically, reviewed repeatedly and continually coded (Merriam, 1998). In this paper, the instrument used for collecting data contained mostly semi-structured questions. Furthermore, the intention to carry out a face-to-face interview was to identify additional factors that could help in the process of designing questionnaires for later use in conducting empirical research. Therefore, a thorough analysis using the specific software was not necessary as the questions being asked were directing the participants to provide an accurate answer. However, the interviews were audio recorded, and transcribed verbatim. The transcribed verbatim was sent to participants for confirmation of the accuracy of what had transpired during the interview session. Besides, short dialogs were also held with the participants about authors' interpretations of the participants' interviews in ensuring the true meanings of the data.

5. Preliminary findings and implication

The interview took an average time of thirty-six minutes per interviewee. The participants came from different background and expertise. One of the participants works as a bank manager in a foreign Islamic bank. The other five members were an ex-bank manager (conventional bank), an academician (local, private university), a human resource manager, a freelance, and an entrepreneur. Four out of six participants (67%) were Muslims and the other two participants (33%) were non-Muslim. All the five interviews took place at the participant's office except one session which was conducted in the interviewee's car. The information from the face-to-face interview that used semi-structured questions were analyzed and sorted by respondents' identification, issue number, and other characteristics.

The findings are consistent with the arguments of most past studies that relates to sharia compliant. For instance, a survey conducted by Economist Intelligent Unit in 2012 found that Sharia compliant plays a significant role in influencing customers' preferences in Islamic bank (Economist, 2012). The result agrees with previous studies made by Nawi, Yazid, and Mohammed (2013) and Okumuş (2005). The studies by Hegazy (1995), Metawa and Almosawi (1998), Gerrard and Cunningham (1997) and Al-Sultan (1999) establish a similar reason. Issues affecting the virtuous morals such as transparency, trustworthiness, truthfulness, fairness were among the ethical

elements which become apparent during the interviews. Besides ethics, a subject of corporate responsibility and community welfare service also prevail during the interview session. These outcomes provide evidence that customers begin to believe in the elements of ethics and social responsibility when making investment decisions (Anand & Cowton, 1993; Anas & Mounira, 2009; Sairally, 2007). Even though great emphasis was placed on Sharia compliant and ethical issue, however, high return and service quality remain as the important factors that influence customers' decisions. Many studies reveal the influence of religion in shaping customers' behavior when dealing with or making investment decisions with Islamic banking. For example, a study by Omer (1992) on Muslim customers residing in United Kingdom exposes that religion is a principle reason when dealing with Islamic Financial Institution (Omer, 1992). Another study by Muhamad et al. (2006) on Muslim investors in Malaysia establishes that religion has some influence on individual investment decision making. There was no direct question related to religion or religion affiliation being asked during the interview. However, the behavior of the participants concerning on Sharia compliant, "riba" free and virtuous morals signify the influence of religion in moderating customers' decision-making. Based on the above argument, some theoretical and managerial implication can possibly be accentuated. The managers, the industry, and the practitioners should be aware of the shift in customers' behavior that begins to regard other credence of service quality as the criterion in making investment decisions.

6. Recommendations and conclusions

Based on the preliminary findings, this paper proposed that Islamic banking industry gives high priority on Sharia compliance, ethical and social issue as an agenda in attracting depositors to pledge their money in an Islamic banking. Generalization has become the limitation to this study because it did not include other Islamic banks under different environment setting. However, the findings of this study are able to give some dimensions and items such as safety and security, human touch and *zakat* (tithes) for practitioners and researchers to measure customer's behavior in future research particularly in Islamic banking.

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